

Capital Budgeting Guidelines



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Preface

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Capital budgeting is an important aspect of club operations. It involves financial planning for replacement, remodeling and expansion purchases. How much each club spends on its facilities is an economic question which must be evaluated relative to the financial condition and the overall direction of the club itself.

Two of the prerequisites to a sound capital budget are the projection of future resources and the development of a master plan to guide the membership. Effective programming and planning, and the setting of goals are other key elements for club officials to consider when developing a capital budget.

“Capital Budgeting Guidelines” is designed to help club officials understand the budgeting process. It will also provide a comprehensive format for developing a capital budget.

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Introduction

Clubs today are capital-intensive facilities, both in terms of operations and physical improvements. Buildings, grounds and outdoor facilities have a relatively fixed life span and need continuous attention. The average useful life of these assets dictates careful resource planning and allocation. As a club begins the process of determining what improvements it wants or needs to make, it is essential to look at the club's long-range needs.

Maintenance and improvements to a private club's physical aspects require some of the most expensive, and at times difficult, decisions the board of directors is asked to make. Rising costs have also caused club officials to focus more attention on the efficient use of manpower, working capital, and physical assets. Note too, that capital budgeting does not include all items that may need replacement or improvement. The club should establish a policy that sets forth the types of assets that should be treated as capital.

Thus, developing and following a master plan for club facilities is important. Unlike regular short-term capital budgeting, major capital improvements rarely occur more than once or twice in the tenure of a club director or general manager. They also represent huge investments in the club's facilities.

This leaves little room for error. Proper planning, an attentive ear to member needs, a thorough and accurate economic analysis, and good professional advice will go a long way to ensure the successful completion of capital projects at any club.

I. The Planning Process

The planning process should include an analysis of both day-to-day finances as well as long-term allocations for capital improvements, including replacement, refurbishment and expansion. Financial planning should be consistent with any long-range planning initiatives adopted by the board. In addition, a long-term plan approved by the general membership is essential and can provide tremendous guidance to new board and committee members.

During the planning phase, the board also should look at past performance and take note of any changes that have occurred since the last period of capital budgeting. This review is essential to determine changes in approaches and strategies.

When planning for future capital projects, the club should evaluate its position in the marketplace. For example, are the club's facilities competitive with the offerings of other private clubs, commercial restaurants and hotels in the immediate area?

Members want distinct value in return for their investment in the club. A successful capital budgeting program will be one that takes into account member needs and societal trends. Club officials need to periodically assess club facilities and areas where the greatest demand exists. For example, are certain club areas over-crowded at certain times? How functional are the operating areas, especially in the less-noticed back of the house? Is a lack of functionality impairing service to the members?

One of the ways to gather this type of information is to survey the needs of the club membership. Member consensus is vital to the success of any capital program and an effective planning process should always include their input. For example, what changes would the members like to see over the next five years? How do members feel their club could be improved?

Effective planning for capital projects will vary depending on the size of the membership and the complexity of the issues involved. Expect to spend at least several months completing a membership survey and evaluating the data. Focus groups and open membership

meetings are also good ways to gather information from club members.

During the planning process the club should consider the following factors:

Consistency with the club image. In most instances, the current members' decision to join the club was probably based on the perceived image of the club membership and facilities. However, the club dynamic may change as the membership does, so the current wishes of the members need to be known.

Trends in the national economy and local community. These should be evaluated in terms of their potential effect on club services and facilities. Trends might include member preferences for informal dining or more family-oriented facilities.

Community influences or issues. Proper research into possible community influences that might impede progress on the project can prevent unexpected surprises. For example, environmental groups or neighboring housing developments may be opposed to various changes.

The size, age, condition and capabilities of various capital items. This should typically include an evaluation of athletic facilities, interior decor, kitchen equipment, and other mechanical, electrical, safety (especially code) and labor-saving items.

Communications with membership. All specific long-term projects, especially major renovations at a club, should be thoroughly studied and explained to the membership. Communicating the project and proposing financing methods to the members is important, even though it is probably not possible to satisfy all members.

Setting priorities for capital spending is key for those clubs with limited financial resources. Local economic factors, social changes and member demographics should be evaluated and may make it necessary to change some club goals and objectives.

When considering capital expenditures there are often several projects that compete for the attention of the

board. Setting realistic priorities is particularly critical when a club has limited resources. Ranking ensures that the most important and most critical needs will be addressed first. Clubs should consider the following three steps when prioritizing capital expenditures.

1) Mandatory. These are capital projects that must be completed within a short time frame to ensure the club's facilities are functioning properly, and that a significant loss of the club's existing or potential business will not occur. Examples include code violations and safety issues that could result in an accident, flood or fire.

2) Necessary. These are capital projects that should be completed as soon as possible; failure to do so could result in reduced revenues or usage of the club, or lead to mandatory expenditure in the near future.

3) Desirable. These are projects that should be considered as part of the ongoing effort to maintain the club and its facilities in a condition suitable to meet the demands of the membership.

II. Program Oversight

Program oversight of capital projects helps prevent unexpected problems down the line. A five-year capital investment plan containing allocations for capital improvements, including replacement, refurbishment and expansion should be developed and updated annually.

Financial considerations should be properly analyzed to avoid membership obstacles in later years. Clubs that have experienced member losses caused by the economy, smaller-than-expected waiting lists, and reduced initiation-fee income should carefully review all options before proceeding.

A complete examination of how the project will be financed should be undertaken, particularly in the face of changes in the national or local economy. For some clubs, the traditional methods of financing club projects may no longer be feasible and the club may have to consider new approaches.

A sufficient portion of the needed capital should be available before beginning work. A club that proceeds with a project despite inadequate funding may compromise other club functions. The club needs to decide how much capital it wants in house before beginning the project.

If club operating potential looks promising but initial funding is limited, the club may wish to consider building in stages, if this is practical. Planning a project in stages with the ability to build and expand as needed, may serve to protect a club with funding problems. As the club grows and funding is less of a problem, subsequent phases of the master plan can be added. If needs change between the time of the initial building phase and the addition, there may also be an opportunity to update the plan to meet current member needs.

Oversight of the project will be easier if operating and capital funds are segregated in separate accounts. The board of directors should play a key role in ensuring that controls are in place to maintain adherence to goals and objectives. The board should also set up a procedure for authorizing disbursement of funds for the entire project.

Monitor actual activity to verify that any capital expenditures are within budget. One common way to accomplish this is to establish certain control measures, such as a variance report that shows actual performance compared with budgeted projections. Control measures can be effective in ensuring that project costs do not escalate and get out of control. Each club must decide, as a matter of policy, whether to require bids on all major projects and purchases or to buy directly from a known source. Other considerations should include:

- Is the club willing to purchase from vendors who also happen to be club members?
- Is there a board policy requiring all purchasing be done through independent sources?
- Have references been checked on contractors or suppliers to verify quality and consistency of work and each vendor's past history of meeting deadlines?
- Does the club want a local firm which understands the local environment, or a larger, nationally recognized firm to render architectural designs or specify the required work?
- Are the club's and the project's needs better served by a general contractor, who generally oversees the entire project once work begins, or a construction manager, who will oversee only that portion of the project?

III. Role of the Board, Committees, General Manager, & Controller

The board of directors, Planning Committee, Finance Committee, general manager and club controller must all work together to ensure that capital budgeting is effective. Depending on the club's culture, the Finance Committee's role is generally to advise.

Board of Directors

The board's responsibilities include:

- Setting the club's mission, goals and objectives in relation to capital projects or expenditures
- Soliciting ideas and opinions from the general manager and controller, to bring them into the planning phase
- Coordinating with the Finance Committee in overseeing the entire capital budgeting process, including cost analysis (see Section VIII, p. 15)
- Determining the most effective financing vehicles
- Surveying the membership and obtaining their support for various projects

Planning Committee

In many clubs, the Planning Committee plays an integral part in the process by developing and maintaining a comprehensive three- to five-year plan that is consistent with the club's mission statement. This plan should address all major facets of the club's facilities and services, finances and physical plant. At least some members of the committee should be conversant with legal, financial, construction, engineering and operating components associated with capital programming. The Planning Committee's responsibilities include:

- Cooperating with the board of directors and the general manager to develop a long-range plan for the club
- Reviewing the needs for all current services, assumptions and recommendations in the existing plan
- Monitoring social and cultural trends through market research to ensure that the long-range plan is consistent

- Working with management to determine club usage rates, status of facilities and levels of member satisfaction
- Coordinating with the Finance Committee to ensure recommendations are consistent with operations, budget projections, cash flow and potential revenues

General Manager

The general manager's responsibilities include:

- Coordinating certain aspects of the budgeting process as delegated by the board of directors, especially research into various requirements, options and solutions
- Working with the treasurer and the club's controller to develop revenue estimates and financing alternatives and alerting the treasurer to any potential variances
- Working with the Finance and Planning Committees to coordinate and implement policies relative to the project
- Coordinating the day-to-day process of the project with the project manager
- Developing a plan to communicate the capital project or expenditures to the membership and help build support
- Developing and implementing plans to minimize member inconvenience during work phases

Controller

The club controller's responsibilities include:

- Providing historical data and estimating revenues
- Developing cash flow projections
- Incorporating revenue and expense estimates into final budget documents for board approval
- Researching finance options

IV. Capital Replacement vs. Expansion

It is helpful at this point to distinguish between different kinds of capital expenditures. However, there are some big differences in the way an expenditure for new dining room furniture is handled versus the way spending for a clubhouse addition is handled. Different clubs will treat capital program items differently, but they are usually separated into two categories with the following characteristics:

Capital Replacement/Enhancement

- Single items costing more than an agreed upon amount
- Common replacement or additional enhancement items
- Short-term items which are normally funded through cash flow in the same fiscal year

Depending on the quantity and scope of the club's purchases, these items may include:

- Drapes, carpets and furniture
- Linens
- China, glassware and flatware (with sufficient inventory for breakage and theft)
- Golf carts and maintenance equipment
- Kitchen equipment, including ovens, dishwashing equipment, refrigerators and freezers, preparation tables, and serving units

Each year, the general manager should review the condition of current equipment and evaluate the club's replacement needs. Normal replacement periods or useful life of various club assets will vary. Following this review, money should be allocated to fund the capital budget. One method allocates a percentage of the club's gross revenues. This percentage varies based on the type and size of the club.

Some clubs may wish to follow this set-aside method. However, clubs need to be careful about committing to fixed percentages or restricting funds only for that

purpose, since spending needs and expenses can vary from year to year.

Capital Expansion

- Large-scale expenditures that require input and approval from membership
- Major equipment purchases, renovations or additions
- Cannot be funded through normal operating budget
- Requires additional funding mechanism, e.g., assessments, loans, dues increases or investment income

Capital expansion projects may include:

- Remodeling or renovation of facilities
- Replacement of the kitchen
- Heating, ventilation and air conditioning systems
- Fire protection sprinkler systems
- Golf course renovation and landscaping
- Roads, parking areas and curbs
- Outdoor lighting
- Tennis courts or other programs that require surfacing and equipment
- Extensive walkways or terraces
- Swimming facilities
- Cabanas or bathhouse and locker facilities

A complete discussion of expansion programs follows in Section V.

V. Capital Expansion Programs

Capital expansion programs are generally those expenditures that require more funding than is available in a normal, annual operating budget. These projects are typically characterized as long-range capital projects. They may be physically completed within a year, but their total planning and execution usually spans more than one fiscal period.

Effective planning for major capital expansion projects should start with the Planning Committee. The committee's role is to integrate the direction of the club's capital improvement projects with the club's mission and overall member needs.

The board should also consider what potential effects a major expansion project will have on other club operating costs. Many clubs forget that larger, even modernized, facilities often involve significant increases in labor costs, utilities, repair and maintenance, and ad valorem property taxes. Other potential costs include short-term loss of income during construction, depreciation and loss of interest income.

Some of the larger costs that should be carefully evaluated include:

Land

Land acquisition as part of a major facility or golf course expansion should be carefully evaluated. Outside fees and legal costs should also be factored into the total acquisition cost. Be sure to include costs such as appraisal fees and points. Additionally, make sure that a full title search is conducted and the land is not encumbered by rights-of-way, projected power lines or other easements that might affect future use or the value of the property.

Some lenders may also require an environmental assessment to ascertain any past or hidden environmental damage. Aside from contamination issues, the club will need to be aware of any potential impact on wildlife, especially protected species.

Other fees that should be considered in relation to land may involve water and percolation tests. These types of tests may be needed to determine water run-off

problems, and the types of sewer disposal facilities that maybe required. Soil tests may also be necessary to verify the feasibility of the land holding the weight of the building and footings.

Facilities and Equipment

The type of capital project drives the selection of materials and equipment that should be included in a cost evaluation. Kitchen renovations may require structural, electrical and plumbing changes that must be costed out. Golf course renovations, on the other hand, may include changes to maintenance facilities, golf car storage, golf car paths, and shelters.

Construction and Demolition

A construction cost estimate for each of the components, prepared by qualified design and engineering professionals, will help determine its impact on the membership. Each component should be evaluated separately to determine its cost effectiveness.

Construction costs will also be driven by the type of project. The cost of renovating or modifying a golf course, for example, should include basic course construction, irrigation systems, bridges and cart paths. Factors related to the unique problems associated with the contour of the land, the type of soil, the vegetation, wetlands restrictions and other environmental factors should all be included. The cost of complying with any governmental regulations such as the Americans With Disabilities Act or Occupational Safety and Health Administration (OSHA) requirements for the proper storage of hazardous materials also should be considered.

Architects

It can be helpful to begin working with a competent architect and other design professionals as soon as possible so that they can become familiar with the club, its members, and the overall objectives of the project.

Although architects are trained in various types of building design, it is important to look for an architect or firm that is familiar with club construction and de-

sign and can respond to issues relating to the overall design of the physical club facilities.

Although many firms specialize in the design of club facilities, the club may have some additional, specific requirements such as a specialty in hotel or kitchen design, period restoration, or a specialty in country clubs versus city clubs. Ask specifically for a description of previous club experience and solicit written credentials.

An architect should provide design leadership by:

- Developing and refining the master plan, including short-term and long-range needs, cost estimates and implementation schedules
- Outlining the firm's proposed approach to the project
- Providing project designs
- Assisting with the bidding process
- Administering and reviewing contractor work

In addition to overall design work, a competent architect should also be able to provide the club with advice on proper lighting, structural issues, building codes and zoning ordinances. The firm should be able to recommend heating and cooling systems specific to building needs and be familiar enough with the climate to ensure the systems will work properly.

When renovating or building a golf course, look for an architect with experience in course design, and who will consider the correlation between the clubhouse and the course. If the project involves changes to both the clubhouse and the course, the architects should work together during the planning stages to avoid serious compromises.

The range of architectural fees will vary widely depending on the scope of the project and the type of work contemplated. On limited projects the charge may be a flat fee. Sometimes an architect's fee may be based on a percentage of the overall construction project. It may also be necessary for the architect to complete preliminary design work for the project in

order to provide rough cost estimates. Ask what additional costs may be added that are not included in the original bid, such as engineering or surveyor fees.

Interior Designers

Furnishing the area with drapes, carpets, artwork and furniture will often require the services of an interior designer. The interior designer should be selected early in the process to ensure consistency throughout the project.

Compatibility is also important. The designer will be working closely with members and vendors to ensure that style, taste, color and fit of furnishings will complement the needs and culture of the club and its members. Choose a commercial designer over a residential one. A commercial designer can best advise the club on commercial-grade finishes and furnishings which withstand wear and tear. A commercial designer is also more likely to know about fire retardants and other maintenance treatment dictated by local laws and regulations. Design firms can be helpful in providing the club with information on up-to-date resources, technology, price information and design options. Service options will also depend on what the project necessitates, from purchasing, delivery and installation to maintenance.

The designer should work closely with the Planning Committee and architect to ensure a sense of integration of the project and proper use of space, including placement of electrical outlets and overhead or spot-lighting. Also, verify the fees. Fees generally cover the time the designer spends selecting furnishing finishes, artwork, accessories and other items. Fees may be charged in several ways: on an hourly basis, as a flat fee (sometimes called a "not-to exceed" fee), or in terms of cost plus a percentage markup.

VI. Financing

Every club must determine how various club activities and the facilities which house them will be supported—whether and how the financial burden of maintaining the facilities will be distributed among the members. Before compiling financial projections, a funding philosophy must be determined. Only then can funding alternatives be clearly identified and analyzed.

When analyzing funding options, the board should evaluate how the membership will accept the proposals offered and what other competitive forces may affect the project. For example, do the members expect to support the construction but demand that any resulting programs or services be self-sustaining? When do members expect a return on the investment? These are all questions that the club should address in advance.

A projection of the financial impact of membership losses due to opposition to the project should also be considered. Even if the majority of members support the project, some members may be upset enough to resign. If new members will be required to finance the project, their reaction to an assessment or other member-driven financing option should also be considered.

Before selecting a funding mechanism for a project, the following issues should be addressed:

- Is the club's membership static, growing or changing?
- Is the membership prepared or equipped to fund most of the capital improvement?
- What is the economic forecast for the community? Will it cause the membership to change?
- If the club adds new members, how will usage rates be affected? How will changes in usage rates affect club operations?
- What would be the impact of a marketing plan to attract additional members and retain current members? This is especially important if new members are needed to make the capital improvements or expansion of the club financially feasible.

Assuming a capital project is rational and well-supported by the membership, the question will remain whether or not it can be properly financed. Depending on cash demands and revenue expectations, the club may consider a combination of financing options.

Increasing Initiation Fees

Before proceeding with an increase in initiation fees to fund capital projects, the board or the Planning Committee should first determine how the increase will affect potential members. The following issues should be addressed:

- How do the club's initiation fees compare with those of similar clubs in the area? Are they competitive?
- Will increasing initiation fees produce more capital? If so, what is the impact on the growth of the club or the retention of the fixed membership quota?
- To what level can initiation fees be increased? Will the club still be able to attract additional members at this initiation fee level?
- Are new clubs in the area siphoning off member support on which the club is relying to complete the project?
- If new members are necessary to finance a major capital improvement project, how many new members will the club need, and how much revenue can be generated?
- If a significant number of new members are needed, is the club equipped to handle the increase? Are facilities sufficient to provide the services the new members may require?

Special Assessments

Many club charters or bylaws allow directors to levy assessments. In most cases, the charter provides that a special assessment can be used to generate funds for a club improvement project.

For example, the board may wish to consider a one-time capital improvement assessment for the entire project.

The difficulties with this approach are determining the amount and whether the membership will agree to the special assessment. Some clubs may also wish to consider an installment option, with payments made over a limited, fixed period of time. Refundable assessments are popular for large capital programs when the cost per member begins to exceed \$5,000.

- Do club bylaws have a limitation on assessments that precludes them as a viable funding source?
- Will an assessment be endorsed by the membership? Will it create a sense of ill-will?
- At what amount will members choose to resign rather than pay the assessment?
- How and under what terms will the assessment be made? Will it be refundable when the member resigns from the club?

Increasing Dues

A dues increase is a lasting change. Because of the possible negative reaction from members, it should not be the only option considered. If the board determines that a dues increase is necessary and the club's members are able to financially carry a capital project, then several other issues concerning dues will need to be addressed:

- How will a capital dues assessment impact the club's ability to raise dues for operational purposes?
- How does the club's dues structure compare with similar clubs in the area?
- Are dues competitive, or will a dues increase force members to switch to other clubs?
- Can dues be increased without affecting membership size? If so, by how much?
- How many members are expected to resign within different ranges of dues increases?

Borrowing Funds

If the club is not able to internally generate the funds necessary to go forward with the project, it may consider borrowing funds. The board should keep in mind that a lender will ask for future operation forecasts and assurance that the loan will be repaid. Therefore, all the statistics developed and assumptions made to determine the project's financial feasibility should be carefully recorded. In addition, terms of the loan may include a lien against club property and other guarantees.

When considering borrowing funds from an outside lender, such as a bank, the board should determine:

- Where should financing be sought?
- How much, over what period of time, and under what terms should the club borrow?
- What impact will the interest rates and costs have on annual operations?
- Will a reassessment of operations be needed to determine how the loan will be repaid?

Member Bonds

As an alternative to an outside lender, the club may be able to finance the project entirely through some form of member borrowing. Some clubs have sold bonds (entirely or partially noninterest-bearing) to members with various time frames for calling or canceling the bonds through amortization.

The impact of such financing schemes should be projected in the forecast the same as any other type of financing. Outside legal and tax counsel should be consulted when considering member bonds to ensure that all state and federal regulations have been considered.

Remember, no matter the method chosen, ultimately the cost of the project is borne by the members.

VII. Guidelines for Capital Campaigns

When implementing a large capital campaign, consider these guidelines:

- Club minutes or other documentation should clearly indicate that the solicitation is for a capital campaign and any monies received will be so designated
- The board should clearly state that the facilities to be built with the funds are available for the use by its members, and that income is to be used to provide services for the members
- The use of funds is contingent only in the sense that sufficient funds must be donated by club members in order to commence construction
- All capital campaign funds will be kept in a separate and identifiable account, and any expenditures will be properly accounted for
- Work should commence promptly when sufficient funds are received

VIII. Preparing the Economic Analysis

Since capital projects are often the most costly expenditures for the club, a careful economic analysis should be performed after the financing alternatives have been reviewed. With the assistance of the club's controller or outside accountants, a complete financial analysis of costs and revenues associated with the project should be prepared.

An analysis of the club's debt structure should also be undertaken. The analysis should include the term of any existing debt, prepayment penalties and any default or acceleration possibilities.

Executive Summary

The economic analysis should be set forth in a written report that includes an executive summary as well as an economic justification. The executive summary presented to the board of directors should contain the following information:

- A short description of the project
- Project costs, including timing of various expenditures
- Financing options and a review of the club's current debt structure
- Summary of the economic analysis for the project
- Impact, if any, to current club operations during the construction phase
- Proposed changes in staffing or modified hours of operation during the construction process
- A list of any additional information that is relevant to the project

The economic justification should be a clear and unbiased appraisal of the major economic assumptions used in evaluating the project.

The following components should be included:

- A brief description of the project and completion costs

- Critical assumptions upon which the project evaluation is based
- Internal and external financing alternatives, including amounts and terms if loans are necessary

IX. Communicating Capital Programs to Members

Once a major project is approved by the directors, the plan, including the method of financing, should be presented to the membership in a manner consistent with the club's bylaws, which customarily govern how capital decisions will be made. This is usually the point at which projects are made or lost, especially if the membership perceives they are poorly designed or underestimated.

Communication with members can take several avenues. The board can schedule a "town hall" meeting at the club. Members are invited to attend an informal presentation conducted by the board, general manager, and the various designers and architects involved in the project. All necessary visual aids, samples of fabrics, rugs and color schemes can be displayed.

Architectural renderings of the project should always be included to help members visualize the final result. Using an overhead projector, charts or slides can also be helpful. Photography of existing facilities juxtaposed with renderings of proposed renovations can also be useful.

The second part of the presentation should focus on the financial implications of the project. Club officials should anticipate member concerns in this area and be prepared to address questions with precise, detailed answers.

The member presentation should make a case for:

- The necessity of the project
- The expected financial and service benefits
- The timing (and its rationale)
- Alternatives if the plan is not accepted
- How the project will be financed
- Other options available

The informal atmosphere of the presentation, along with discussion questions and comments from the membership, can be helpful in obtaining full approval by the membership and support for the financing option. Remember, if planning is poor, members may ask

why their club no longer measures up to their expectations. But if handled properly, and members are provided with clear information concerning the project, support is more likely.

Summary

Capital budgeting is a critical resource management tool for every club. It is incumbent upon board members and club management to properly allocate the physical assets of the club. Development of and adherence to a long-range facility plan can ensure that the club's resources are properly allocated to capital replacement and expansion projects.